



# What Could Go Wrong?

How Failure to Perfect and Other Deficiencies May Extinguish Your Lien in Bankruptcy

Aaron Bell  
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# Brief Overview of Bankruptcy Players

- **United States Trustee**
  - Government's watchdog
- **Chapter 7, 12, 13, and sometimes 11 Trustee**
  - Marshalls and liquidates assets
  - Avoids transfers to claw back assets into the estate
  - Distributes assets of the estate to creditors of the estate
  - Administers reorganization plans
- **Debtor in Possession – Chapter 11**
  - Acts in the same capacity as a chapter trustee

# Trustee/DIP's Avoidance Powers

- **Chapter Trustees and DIPs May Avoid:**
  - **Preferences – 11 U.S.C. § 547**
    - Certain payments to creditors that are deemed unfair to other creditors
  - **Fraudulent Transfers – 11 U.S.C. § 548**
  - **Post-petition Transfers of Property of the Estate – 11 U.S.C. § 549**
  - **Liens and Certain Other Prepetition Transfers – 11 U.S.C. § 544**

# 11 U.S.C. § 544 Avoidance Powers

- **(a)** The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by—
  - **(1)** a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists;
  - **(2)** a creditor that extends credit to the debtor at the time of the commencement of the case, and obtains, at such time and with respect to such credit, an execution against the debtor that is returned unsatisfied at such time, whether or not such a creditor exists; or
  - **(3)** a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exists.

# 11 U.S.C. § 544 Avoidance Powers

- **The Courts have explained that 11 U.S.C. § 544(a)**
  - **Gives chapter trustees/DIPs rights and powers of hypothetical judgment creditor with a lien**
    - If hypothetical creditor prevails under state law, trustee/DIP prevails
    - If hypothetical creditor loses under state law, trustee/DIP loses
- **With regard to liens, the hypothetical § 544(a) creditor would have priority over an unperfected lien, so the trustee/DIP can avoid unperfected liens**

# Examples

- **Vehicle Titles Failing to List Lienor**
  - Individual debtor personally guaranteed business debt
  - Pledge personal car as collateral
  - Lender recorded lien on title after post-petition
- **Deed of Trust Provides Insufficient Property Description**
  - Address or parcel ID insufficient based on statute of frauds
    - In re McMurdie, 448 B.R. 826 (Bankr. D. Idaho 2010)
      - DOT referenced unattached legal description
- **UCC-1 States Incorrect Name for Debtor**
  - *Bankr. Estate of Wing Foods, Inc. v. CCF Leasing Co. (In re Wing Foods)*, Nos. 09-40154-JDP, 09-08062, 2010 Bankr. LEXIS 114 (Bankr. D. Idaho Jan. 14, 2010)

# Preservation of Lien for the Estate

- **Once the trustee/DIP avoids the lien the trustee/DIP can preserve that lien for the Estate**
  - **11 U.S.C. § 551**
    - “Any transfer avoided under section 522, 544, 545, 547, 548, 549, or 724(a) of this title, or any lien void under section 506(d) of this title, is preserved for the benefit of the estate but only with respect to property of the estate.”
  - **This has been interpreted to mean that the avoided lien is preserved for the estate, and the estate is put into the same position it would have been in but for the avoided lien.**
    - *Hopkins v. Dig. Fed. Credit Union (In re Parker)*, Nos. 14-40133-JDP, 16-8004-JDP, 2016 Bankr. LEXIS 3982, at \*9 (Bankr. D. Idaho Nov. 15, 2016)
  - **If the lien property is no longer in the estate, 11 U.S.C. § 550 provides a remedy for recovering the value of the lien. That is not covered by this presentation**

# What Happens to the Lienor

- **If the lien is avoided, the creditor may file a proof of claim to assert an unsecured claim in the bankruptcy case within 30 days of the judgment.**
  - Fed. R. Bankr. P. 3002(c)(3)
  - If prior proof of claim was filed, the creditor can simply amend it
- **If transaction voided (i.e. land transfers), the creditor may file a proof of claim to assert an unsecured claim in the bankruptcy case within 30 days of the judgment.**
  - Fed. R. Bankr. P. 3002(c)(3)



# Takeaways and Recommendations

- **Bankruptcy adds heightened scrutiny to your transactions**
- **Any flaw that would invalidate a transfer of property or security interest under state law may result in avoidance in bankruptcy court**
- **Any flaw in perfecting a security interest may result in avoidance of that security interest in bankruptcy court.**
- **Recommendations, especially for distressed transactions**
  - Ensure correct details are stated in deeds, deeds of trust, financing statements, and vehicle titles
  - Ensure a sufficient description of real property or personal property is used
  - Ensure that financing statements are filed in the correct jurisdictions
  - Ensure that perfection is completed as soon as possible
  - **BECOME A BANKRUPTCY ATTORNEY AND LEAVE TRANSACTIONS BEHIND**

# Questions?